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Supreme Court, U.S.
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No. 04-206

IN THE

Supreme Court of the United States

SL SERVICE, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

REPLY BRIEF

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REPLY BRIEF

The petition demonstrates that the ruling below is at odds with the plain language of the vessel repair statute, arbitrarily departs from decades of administrative and judicial precedent, undermines longstanding federal policy, and endangers an industry critical to the nation's security. Respondent either ignores or sidesteps each of these points.

1. Respondent does not dispute, or even engage, petitioner's showings that the U.S.-flag merchant fleet serves vital national security functions, and that the fleet is in deep trouble and can scarcely afford the substantial increase in operating expenses that the Federal Circuit's ruling will cause. Pet. 2-6, 22-23. Respondent instead tries to discount petitioner's showings as "unproven conjecture" without support in the record. Opp. 11. That response is deeply misguided. For one thing, petitioner's showing depended largely on the Government's own documents. See, *e.g.*, Pet. 2-5 & n.1. For another, questions about the importance of a case, for purposes of this Court's decision whether to grant review, almost never appear in the record; certainly they cannot be waived or forfeited, as respondent suggests. Respondent's dismissive treatment of the real-world backdrop of this case thus is both disingenuous and inapposite.

Respondent does not and cannot deny that the ruling below will harm a vital industry that is already against the ropes, at a time when the nation can ill afford it. Even with ballooning budgets, military resources are stretched taut. The Defense Department cannot begin to supply the vessels or the manpower for the massive cargo movements required by current and prospective military engagements, a task taken up chiefly by the U.S.-flag fleet—this on top of the broader economic importance of the merchant marine. In this light, surely the serious adverse impact of the ruling below warrants this Court's review.

2. The petition explains at length why the ruling below is arbitrary and contrary to the plain language of the vessel repair statute. Pet. 17-22. None of respondent's rejoinders withstands scrutiny.

a. Begin with the common ground. Respondent concedes that the decision below is inconsistent with the body of practice and precedent ending only a decade ago. Until the Federal Circuit's 1994 *Texaco* ruling, "expenses of repairs" was construed in accord with its commonsense meaning: "those expenses 'directly involved' in the repairs, such as costs of parts and labor." Opp. 2-3. Thus, it is undisputed that the decision below is at odds with a century or more of administrative practice and judicial construction.

There is no ambiguity as to what constitutes "expenses of repair." The expenses of general service, drydocking, inspection, repair, maintenance, and modification are readily segregable. Indeed, the Customs Service has no problem identifying what constitutes an expense of repair. However, instead of imposing duties only on those expenses, as the statute commands, the Customs Service (with the blessing of the Federal Circuit) also uses those expenses as the numerator in a formula to assign certain other expenses to the "repair" category and thus impose massive duties upon them. As Judge Bryson pointed out, nothing in the statute authorizes apportionment of nonrepair expenses to the dutiable "expense[s] of repair." Pet. App. 12a (Bryson, J., dissenting). Indeed, it would have been passing strange for Congress to impose an elaborate apportionment scheme when it enacted the vessel repair statute in 1866, when the size and scope of the federal government were a fraction of what they are today.

Not only is the decision below contrary to the plain meaning of the statute, but the Federal Circuit has now given the simple term "expenses of repair" mutually inconsistent meanings depending on the expenses at issue. The court below left in place the rule of *Texaco* (which itself was a de-

parture from precedent) for what it deemed single-purpose expenses. Under *Texaco Marine Servs., Inc.* v. *United States*, duties are imposed on expenses "which, but for dutiable repair work, would not have been incurred," but are not imposed on "expenses that would have been incurred even without the occurrence of dutiable repair work." 44 F.3d 1539, 1544 (Fed. Cir. 1994); see Pet. App. 4a, 10a. The latter describes exactly the drydocking expenses here. Because the PACIFIC had to be placed in dry dock to conduct the required inspections, the expenses would have been incurred even without the occurrence of dutiable repairs. Conversely, the clean-up expenses at issue in *Texaco* (see 44 F.3d at 1541-42), which were held dutiable under the but-for test, would not have been dutiable under the newfangled test announced below because they were not "required" in order to perform the repair. Pet. App. 7a. Respondents never explain how a single statutory phrase "expenses of repair" can have mutually exclusive meanings when applied in different contexts.

b. Respondent's efforts to square the circle and reconcile the holding below with *Texaco* and with the statutory language are unpersuasive. First, the contention that *Texaco* applies only to "'single-purpose expenses,'" Opp. 7 (quoting Pet. App. 4a), is belied by *Texaco* itself, which on its face dealt with dual-purpose expenses. With regard to the clean-up expenses that were at issue in that case, the court stated that "'but for' dutiable repairs, the clean-up work, *at least in part*, would not have been required"—indicating that the clean-up work was occasioned by both dutiable repairs and other causes. *Texaco*, 44 F.3d at 1548 (emphasis added); see also *id.* at 1548 n.9 ("it appears that some cleaning of the cargo tanks to prepare them to carry cargo would have been necessary even if the repairs had not been made"). Thus the costs at issue in *Texaco* were not, as respondent asserts (Opp. 7), "necessitated solely by dutiable repairs."

Second, respondents' claim that the decision below simply refines the *Texaco* standard by borrowing a "concurrent-

caus[ation]" standard from tort law is flawed. Opp. 7-8. As an initial matter, tort concepts of causation have never (prior to *Texaco*) been applied to customs duties; in customs law, "the question is not whether and how to compensate the victim of a wrong." Pet. App. 11a (Bryson, J., dissenting). More fundamentally, the test that the Federal Circuit applied here—whether drydocking is "required" in order to perform the repairs that were made to the *PACIFIC*, *id.* at 7a—is not a causation test (concurrent or otherwise). As petitioner has explained (Pet. 16), the drydocking was "caused" by mandatory Coast Guard and ABS inspections. The inspections were the reason the ship docked in Hong Kong, and the record shows that the ship remained in dry dock for only as long as the inspections took. That the owner took the opportunity to make repairs while the ship was out of commission does not change the purpose of the drydocking. There is no evidence that these were urgent repairs; they could as well have been undertaken during another docking at another port.[1]

An analogy illustrates the point. A car owner takes her car to a certified service station for a mandatory inspection, and then decides to have the brake pads replaced since the car will be in the shop anyway. Even though the car must be in the service station to have the brake pads replaced, that ancillary task did not *cause* the car owner to go to the station; the inspection mandate did. Similarly, a hull repair that SL Service decided to have done while the *PACIFIC* was in dry dock did not *cause* the ship to dock in Hong Kong in November 1995.

In other words, if the assessment of duty on drydocking and related expenses really turns on causation, then it must be predicated on a showing of *actual* cause-in-fact. Cf. W.P.

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[1] Respondent dismisses this as "speculation" without support in the record. Opp. 9. But there is no finding on the record as to concurrent causation because that was not the test applied by the Court of International Trade (which applied *Texaco* but-for causation), or by the Customs Service or the Federal Circuit.

Keeton et al., *Prosser & Keeton on the Law of Torts* § 41, at 263-65 (5th ed. 1984). That is, there must be a finding of fact that (on the facts of this case) the *PACIFIC*, even if it were not undergoing Coast Guard and ABS inspections, would nonetheless have docked in a foreign port during that same voyage in order to make these repairs. By the same token, if a vessel docked for dutiable repairs also undertakes nondutiable modifications, there would have to be findings as to whether the modifications would have been performed under different circumstances.

In short, the Federal Circuit did not announce (and the Customs Service does not apply) a cause-in-fact test. Rather, the Federal Circuit has given the simple phrase "expense of repairs" in a venerable statute a new, muddled, and mutually contradictory interpretation that varies with the expenses at issue, meaning "but-for cause" of the repair in one circumstance and "necessary condition" of the repair in another. The only unifying thread in the decision below is to maximize Customs revenues in every case by capturing all expenses associated with repairs. Such an outcome is antithetical to the statute, and particularly unwarranted given that Congress recently rejected the Customs Service's entreaty to broaden the vessel repair statute to impose duties on "'all costs and expenses associated with'" overseas repairs. Pet. 9. Customs's proposal for amendment betrays its recognition that the vessel repair statute does not reach expenses of this kind, and Customs should not be able to achieve through the courts a change that Congress has denied.

c. Respondent's other objections lack force. Petitioner discussed the illogical apportionment method employed in this case, Pet. 19-21, to illustrate the inherent arbitrariness and unworkability of the ruling below. Respondent's back-of-the-hand answer that these points "were neither pressed nor passed upon below," Opp. 12-13, is off the mark. Petitioner is not, as in *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144 (1970), asking this Court to pass on issues not raised in the

lower courts. See *id.* at 147 n.2, *cited at* Opp. 13. Petitioner merely showed how the rule announced by the panel below would play out on the ground. Neither *Adickes* nor any other precedent to petitioner's knowledge suggests this Court will or should ignore the real-world implications of a challenged ruling in deciding whether the ruling warrants further review.

And respondent fails to engage petitioner's showing in this regard. Respondent asserts conclusorily that "there is nothing irrational" about a rule under which "as the ratio of dutiable to nondutiable work rises, the percentage of docking costs subject to duty rises in direct proportion." But beneath this facile formulation the rule is indeed irrational, and irremediably so. As petitioner explained, Pet. 20-21, the duty on drydocking can vary substantially as a function of costs that have no relation to the dutiable work, and no relation to the time or the facilities required for drydocking. Similarly, the Federal Circuit's rule figures the duty on drydocking based partly on work that does not require drydocking. *Id.* at 19-20. Thus, the rule calls for assessment of a drydocking duty that is partially divorced from both the fact of drydocking and the fact of dutiable work.

The rule adopted below is, in other words, merely a new revenue-raising device with little more than a nominal footing in the repair statute. It is arbitrary as a matter of statutory construction and is internally inconsistent. Respondent has not shown otherwise.

4. Finally, respondent's discussion of the deterrent purpose of the vessel repair statute, Opp. 9-11, misses the mark. Respondent emphasizes that the statute was designed to encourage the use of U.S. shipyards for vessel repairs. *Id.* at 10 & n.3. That is true (see Pet. 7-8), but the observation does not advance the ball. That a statute has a deterrent element does not make it a one-way ratchet, such that all increases in liability further the statute and bounds on liability defeat it. Neither the statutory language nor any indicium of Congressional intent supports imposition of the vessel repair duty on

the cost of docking a vessel incident to ABS inspections and modifications. Indeed, the vessel repair statute has always represented a balancing of interests. Congress has consistently taken care to protect the fleet's interests of the U.S.-flag fleet, both by mitigating the impact of the vessel repair statute and by other ameliorative legislation. *Id.* at 5-6, 8-9, 21-22. The Customs Service until very recently refused to read the vessel repair statute expansively to cover dry docking. An expansion in the expenses subject to duty may deter,[2] but not in service of the statute.

Second, it is reasonable to ask what is being deterred. The vessel repair statute aims to deter shipowners from going overseas to have repairs done—not to deter them from having *inspections* done overseas. (It cannot have the latter purpose, as costs inspection costs are nondutiable.) As both petitioner and respondent have noted, economic realities dictate that a cargo ship be taken out of service as seldom as possible; consequently, it is not only customary but necessary that U.S.-flag vessel operators schedule repairs and other work to coincide with drydockings required for Coast Guard and ABS inspections. *Id.* at 6; Opp. 8-9. Therefore, if the repair statute is construed to impose duty on costs incidental to inspections, the only way a ship operator can avoid the duty is to have the inspections done in U.S. ports. That is not in most cases an available option to ship operators, and it is not a goal of the vessel repair statute.

For the same reason, respondent's leitmotif of duty "evasion" and "defeat[ing]" the repair statute (Opp. 8, 9, 10) is misplaced. Merchant vessels are expressly allowed, without penalty, to undergo inspections (as well as modifications) in foreign shipyards. It is hardly evasive, then, for a ship owner faced with a mandatory inspection to solicit bids from various yards along the ship's route and select the best bid for the job.

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[2] In reality, it generally will not deter, but will only add another fixed cost to ocean transport. *See* Pet. 23.

To have necessary repairs made at the same time is not a bait-and-switch, see *id.* at 9-10, but a business necessity, as respondent concedes. If Congress wishes to tax the costs of ABS and Coast Guard inspections undertaken overseas, it may do so. It has not done so.

Finally, respondent's protestation that this dispute is "appropriately addressed to Congress, not the courts," *id.* at 11, is misplaced. That can be said of any issue of statutory interpretation that is brought to this Court. In any event, respondent has it backward. It was not Congress, but a divided appeals court panel, that vastly expanded the reach of the vessel repair statute. The Federal Circuit should not be able to rewrite in arbitrary ways a federal statute that is of enormous importance to the merchant marine industry, in the face of established practice and contrary legislative intent.

The split ruling below has wrought a change in the law that, if let to stand, will have serious and broad effects on a vital industry. To do so, the panel overruled the well-reasoned decision of a specialized court—the U.S. Court of International Trade—with expertise in trade and tariff matters, which had faithfully applied the Federal Circuit's own decision in *Texaco*. Moreover, the Federal Circuit's exclusive appellate jurisdiction precludes other courts' weighing in. (Thus the absence of a circuit split, see *id.* at 6, far from calling for denial of the petition, militates in favor of a grant.) This Court is the only forum for the re-examination that this case demands.

CONCLUSION

For these reasons and those set forth in the petition, the petition for writ of certiorari should be granted.

Respectfully submitted,

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